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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

March 16, 2001

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
445 12th Street, SW
Washington, D.C. 20554

Re: Rural Task Force Recommendation to the Federal-State Joint Board and Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers, CC Docket Nos. 96-45, 00-256, 98-77 and 98-166

Dear Ms. Salas,

Pursuant to Sections 1.41, 1.415, and 1.419 of the Commission's Rules, enclosed please find the Reply Comments and Motion to Accept Late-Filed Reply Comments of the Ad Hoc Telecommunications Users Committee in the above-captioned matter.

If you have any questions regarding this filing, please do not hesitate to contact me.

Sincerely,

Colleen Boothby

Colleen Boothby

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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	
Federal-State Joint Board on Universal Service	CC Docket No. 96-45
Rural Task Force Recommendation to The Federal-State Joint Board	
Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers	CC Docket No. 00-256
Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation	CC Docket No. 98-77
Prescribing the Authorized Rate of Return For Interstate Services of Local Exchange Carriers	CC Docket No. 98-166

MOTION OF THE AD HOC TELECOMMUNICATIONS USERS COMMITTEE TO ACCEPT LATE-FILED REPLY COMMENTS

The Ad Hoc Telecommunications Users Committee ("Ad Hoc") respectfully requests that the Commission accept the enclosed Reply Comments in the docket captioned above. These reply comments are being filed on March 15, 2001, three days after the filing date established in the Notice of Proposed Rulemaking. The filing of Ad Hoc's reply comments was delayed by inclement weather during the final stages of preparation. Due to an unexpected and severe winter storm that affected the Northeastern United States, Ad Hoc's economic consultants, located in Boston, Massachusetts, were unable to complete their analysis of the issues and portions of the pleading because they were unable to reach their offices. Although they had arranged to perform some work from home in anticipation of the storm, they were unable to do so because the storm also disrupted electrical power to their homes. Because the filing deadline applicable hereto is not statutory, the Commission has full authority to accept these late-filed copies for good cause shown, and has done so in similar circumstances.

Respectfully submitted,

AD HOC TELECOMMUNICATIONS
USERS COMMITTEE

BY Colleen Boothby

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Counsel for
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Users Committee

March 15, 2001

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
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	)	

REPLY COMMENTS OF THE AD HOC TELECOMMUNICATIONS USERS COMMITTEE

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March 15, 2001

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SUMMARY

As discussed in the Ad Hoc Telecommunications Users Committee's comments in this proceeding, the Commission should adopt a universal service support mechanism – for rural and non-rural carriers alike – that is explicit, targeted, competitively neutral, and properly sized to support universal service and nothing more. Moreover, if competition is to emerge in rural and high cost areas, as contemplated by the Telecommunications Act of 1996, the Commission's universal service support mechanism must not handicap the competitive race by reimbursing incumbent rural carriers for inefficient investments.

The Rural Task Force ("RTF"), the Multi-Association Group ("MAG"), and the parties supporting the proposed plans have not proffered evidence that would justify departure from the Commission's earlier decisions to base universal service mechanisms on forward-looking economic costs. Instead, the recommendations of the RTF and the MAG would distinguish rural carriers from non-rural carriers and not only compensate the incumbent rural carriers for inefficient past investment decisions but in addition inflate the universal service fund to unprecedented (and unconstrained) levels.

By relying on an embedded cost model to size the rural carriers' universal service support, the Rural Task Force would encourage economic inefficiencies and create barriers to competition – two results that a forward-looking cost model would avoid.

Nor should the Commission blindly adopt proposals to increase the Universal Service fund by an undetermined amount without (1) a showing from the proposal's proponents that current levels of funding are somehow insufficient to achieve universal service objectives; and (2) a credible quantitative assessment of the separate impact of each recommendation on the size of the fund.

The universal service funding mechanism should make no distinction between rural and non-rural carriers in the type of cost mechanism used to size the fund. Since both rural and non-rural carriers serve high cost areas, both rural and non-rural carriers should be subject to a unified universal support mechanism which ensures that support is targeted to the high cost areas that need the funding the most. A federally funded Universal Service Policy should be driven by concern for the customer, not the nature of the carrier.

The RTF, the MAG, and supporting parties have not provided any evidence demonstrating that there is a need to re-base - or eliminate - the indexed cap on the High Cost Loop Fund or otherwise increase the size of the fund. Accordingly, the Commission should reject the recommendations to increase the current level of universal service support and instead adopt an annual productivity factor to be applied to the indexed cap on the HCL fund. This productivity factor should also be used to re-base downward the cap on the HCL fund to reflect the known productivity increases in the telecommunications industry since the adoption of the indexed cap

The Commission should not remove the cap on Universal Service support for transferred/sold exchanges. This safeguard was established by the Commission to eliminate any incentive for carriers to acquire exchanges based upon potential Universal Service support. If the Commission does adopt the proposed mechanism, the types of investment that will be reimbursed by this mechanism must be explicitly identified. Specifically, the mechanism should *not* recover investments for services that are not currently designated as services eligible for universal service subsidies.

The RTF's "Safety Net Additive" mechanism is similarly flawed because it does not ensure that funding is being directed to a service supported by Universal Service. Moreover, the mechanism proposed by the RTF would encourage carriers to delay investments and reward disinvestments. Accordingly, the Commission should reject the RTF's proposed Safety Net Additive mechanism.

Ad Hoc supports AT&T's suggestion that the RTF's proposed High Cost Fund III (HCF III) be funded with a new per line charge to collect HCF III implicit subsidies removed from per minute charges. But the Commission should apply a productivity adjustment to the new HCF III funding requirement to ensure that the fund does not reward inefficient investments.

Finally, the Commission should reject the Rural Task Force's recommendation to expand support for advanced services facilities. If the Commission continues to believe that the inclusion of advanced services in the Universal Service mechanism is appropriate, Ad Hoc urges the Commission to open a new proceeding to address the issue and consider both the statutory standard for extending subsidies to a service and the dollar impact of doing so on the fund and other beneficiaries of support, both carriers and customers.

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FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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REPLY COMMENTS

The Ad Hoc Telecommunications Users Committee ("Ad Hoc" or "the Committee") hereby submits its Reply Comments in response to the initial comments filed pursuant to (1) the Commission's January 12, 2001 Further Notice of Proposed Rulemaking[1] seeking comment on the Recommended Decision of the Federal-State Joint Board on Universal Service ("Joint Board") regarding the Rural Task Force's ("RTF's") recommendation to reform the rural

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[1] *Federal-State Joint Board on Universal Service*, CC Docket 96-45, FCC-01-8, Further Notice of Proposed Rulemaking, (rel. Jan. 12, 2001) ("*RTF FNPRM*").

universal service support mechanism;[2] and (2) the Commission's January 5, 2001 Notice of Proposed Rulemaking[3] seeking comment on the petition of the Multi-Association Group ("MAG") to reform interstate access and universal service support policies for ILECs subject to rate-of-return regulation.[4]

INTRODUCTION

Ad Hoc's members are among the nation's largest high-volume consumers of telecommunications services and facilities. The Committee supports the adoption of regulatory rules and policies that encourage the availability of competitive, high-quality telecommunications services and facilities at reasonable prices. To that end, Ad Hoc has consistently supported universal service subsidies as long as those subsidies are properly sized, collected, and distributed in an economically efficient and pro-competitive manner.

In its Comments, Ad Hoc urged the Commission to reject many of the recommendations of the RTF and the MAG, because they would harm ratepayers and the public interest. Collectively, the recommendations of the RTF and the MAG would not reflect an appropriate quantitative assessment, or efficient use, of universal service support and would impede the development of competition in the rural and high cost areas of the country.

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2 *Federal-State Joint Board on Universal Service,* CC Docket No. 96-45, FCC 00J-4, Recommended Decision (rel. December 22, 2000).

3 *Federal-State Joint Board on Universal Service*, CC Docket Nos. 00-256, 96-45, 98-77 and 98-166, FCC-00-448, Notice of Proposed Rulemaking (rel. January 5, 2001).

4 Petition for Rulemaking of the LEC Multi-Association Group, RM No. 10011, filed October 20, 2000 ("*MAG Petition*"). The MAG is comprised of the National Rural Telecom Association (NRTA), National Telephone Cooperative Association (NTCA), Organization for the Promotion and Advancement of Small Telecommunications Companies (OPASTCO), and United States Telecom Association (USTA).

As Ad Hoc explains in greater detail below, the comments have failed to provide a justification for the changes recommended by the RTF and the MAG. In addition, the comments include no data or other record support that would enable the Commission to determine what the quantitative impact of the RTF and MAG proposals would be or whether they would meet the statutory standards for universal service support mechanisms. Accordingly, Ad Hoc urges the Commission to reject the proposals and take up once again its effort to develop a forward-looking economic cost approach for rural carriers.

I. The RTF Has Failed To Justify Abandonment Of A Forward-Looking Cost Methodology

Certain commenters, including the National Exchange Carrier Association ("NECA"), the National Telephone Cooperative Association ("NTCA"), the Rural Independent Competitive Alliance ("RICA"), the Public Service Commission of the United States Virgin Islands ("PSC-USVI"), and the South Dakota Independent Telephone Coalition ("SDITC"),[5] support the RTF's recommendation that the Commission abandon forward-looking cost models in favor of an embedded cost model for sizing rural carriers' universal service support.[6] Yet these commenters fail to provide an adequate justification for their positions. Absent such a justification, the Commission should not allow itself to be deflected from its choice of a forward-looking cost ("FLEC") approach as the most appropriate for measuring universal service support for rural carriers.

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[5] These acronyms will be used in the footnotes to refer to these organizations.

[6] *See, e.g.,* NECA Comments at 3-5; NTCA Comments at 2; RICA Comments at 8; PSC-USVI Comments at 3-5; SDITC Comments at 3-4.

Ad Hoc agrees with the assessment of the People of the State of California and the California Public Utilities Commission's ("California") – and the FCC, for that matter, in its prior consideration of this issue – that the methodology for funding universal service to high cost areas, both rural and non-rural, must be based on forward-looking principles.[7] As Ad Hoc pointed out in earlier universal service proceedings[8] and in its initial comments in this proceeding,[9] any reliance on a carrier's embedded costs to determine universal service support, like the RTF recommendation, rewards inefficient past investment decisions and obstructs the development of competition. As WorldCom observes, "support calculations based on embedded costs inherently include inefficient as well as efficient expenditures. And calculations based on embedded cost may also include costs associated with advanced services and other services that are not included in the Commission's definition of advanced services."[10] The use of a FLEC model, on the other hand, ensures that support levels correspond to the true cost of providing universal service and thereby both encourages competition in rural areas and promotes efficiency in the provision of universal service.

Despite the Commission's previous determination that a forward-looking model is the appropriate mechanism to determine rural carrier support, [11] the

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7 California Comments at 2.

8 *See, e.g.,* Reply Comments of Ad Hoc Telecommunications Users Committee, CC Docket No. 96-45, filed May 7, 1996; Comments of the Ad Hoc Telecommunications Users Committee, CC Docket No 96-45, filed December 19, 1996.

9 Ad Hoc Initial Comments at 4.

10 WorldCom Comments, at 3 (footnotes omitted); *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order, 12 FCC Rcd 8776 (1997) ("*Universal Service Order*").

11 Ad Hoc Initial Comments at 8 *citing Universal Service Order* at 8935-36.

RTF is urging the Commission to preserve the current "cost plus" system which reimburses carriers for their costs regardless of whether the costs were efficiently incurred or whether the development of competition would be undermined. But the RTF has failed to proffer any financial or economic data demonstrating that rural LECs would be unable to fulfill their USF responsibilities under the funding levels that would result from the use of a FLEC model. The RTF's recommendation to continue using embedded costs appears to be based upon little more than a knee-jerk reaction to the fact that the total level of funding produced under a FLEC model might be lower, rather than relying on some empirical analysis of the impact of the change in funding level on the availability of universal service. Ad Hoc urges the Commission to stand by its previous determination, and to complete the intended transition of the rural carriers' support mechanism to a FLEC methodology.

Ad Hoc agrees with WorldCom and AT&T that it may be necessary to continue using an embedded mechanism for a limited period during a transition to the use of a FLEC model. But Ad Hoc can not endorse the five- year extension proposed in AT&T and WorldCom's comments.[12] Like the California PUC, Ad Hoc is concerned that the RTF has provided no compelling evidence that could justify the delay in adoption of a FLEC methodology or the continuation of the use of embedded costs to determine rural carrier universal support.[13] If the Commission chooses to continue using an embedded cost mechanism for an interim period while a more efficient forward-looking mechanism is developed,

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[12] WorldCom Comments at 3; AT&T Comments at 13.

the interim period should be no longer than one year since that time frame is sufficient to develop the requisite mechanism and inputs.

Furthermore, Ad Hoc agrees with California and WorldCom that the RTF has failed to engage in a thorough analysis of the development of rural-specific inputs for a FLEC model.[14] According to California,

> (T)he RTF concludes that a mismatch between embedded costs and the results of the Synthesis Model means that the Synthesis Model is flawed. The RTF, however, gives no consideration to modifying or improving the FCC's Synthesis Model for rural carrier purposes prior to concluding that universal service support should be based on embedded costs.[15]

Ad Hoc concurs with California. The RTF simply did not fulfill its mandate to evaluate whether the "FLEC mechanism for rural carriers should have different platform design features or input values than the mechanism adopted for non-rural carriers."[16] The RTF was asked by the Joint Board to evaluate rural-specific inputs for a FLEC mechanism,[17] and returned to the Joint Board with not only an abandonment of FLEC principles but additional modifications that conflict with efficient development of competition. Rather than evaluating platform design features or input values, the RTF simply rejected the use of the Synthesis Model used by non-rural carriers. Ad Hoc continues to believe that rural-specific inputs can be developed and incorporated into a FLEC model.[18]

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13 California Comments, at 6.

14 California Comments at 3; WorldCom Comments at 2.

15 *California Comments at 3.*

16 Federal-State Joint Board on Universal Service Announces the Creation of a Rural Task Force; Solicits Nominations for Membership on Rural Task Force, CC Docket No. 96-45, Public Notice, 12 FCC Rcd 15752 (1997) ("*Public Notice: Creation of RTF*")

17 *See*, *Public Notice: Creation of RTF*.

18 Ad Hoc Initial Comments at 9.

Ad Hoc reiterates that, absent the development of the rural specific inputs that should have been developed by the RTF, the Commission must devise a method for moving to the use of the FLEC model.[19] The Commission should either (a) instruct the RTF to revisit the development of rural specific inputs for a FLEC model with a corresponding plan to use the non-rural FLEC inputs if the rural carriers refuse to cooperate with the RTF; or (b) issue another notice in this proceeding, establishing a phase in these dockets for collecting data and calculating rural carrier universal support using the non-rural carrier-specific inputs and the non-rural carrier model as a default mechanism, absent an evidentiary showing by rural carriers that specific alternative inputs should apply.

II. The Potential Dollar Impact Of The RTF Recommendation and MAG Petition Must Be Quantified

As discussed in its initial comments, Ad Hoc opposes the adoption of measures designed to increase the Universal Service fund by an undetermined amount without a showing that such an increase is necessary. Unwarranted growth in the fund will promote inefficiencies and, ultimately, result in higher costs for consumers. At a minimum, the RTF and supporting commenters should be required to (1) demonstrate that current levels of funding are somehow insufficient to achieve universal service objectives; and (2) quantify the separate impact of each of its recommendations on the size of the fund using a FLEC model.

[19] Ad Hoc Initial Comments at 10.

Although the RTF recently filed NECA estimates of the recommendations' impacts on the fund,[20] William R. Gillis, Chair of the RTF, concedes in his letter to the Commission that quantification of the RTF recommendations remains difficult given that there is no data available to estimate the extent to which CLECs will participate, and which disaggregation methodology the ILECs will select.[21]

In addition, some of the assumptions used in NECA's five year growth projections appear fatally flawed. For example, the estimates do not take account of future rural carrier productivity. Thus, the estimates presented by NECA are inadequate and cannot be accepted as an accurate estimate of the impact that the RTF Recommendation will have on the size of the Universal Service Fund.

Additionally, the Safety Net Additive and the Safety Valve Mechanism support seems to be based upon USF data from the year 2000 even though the RTF recommendations contain inherent incentives for carriers to accelerate investment inefficiently to "inflate" their universal service support. As an example, the quantification of the impact of the "safety net additive" appears to have been conducted based upon an assessment of the level of TPIS growth for rural carriers in a period when no "safety net additive" was in place – ignoring the incentives the plan creates for carriers to accelerate into a single year the investment that might normally have occurred over a span of several years

[20] Letter of William R. Gillis to Magalie Roman Salas, Secretary, Federal Communications Commission, November 3, 2000. ("*November 3, 2000 RTF Letter*")

[21] *November 3, 2000 RTF Letter.*

(delaying one year's investment and advancing another), and ignoring the very "spur" in investment that the safety net additive is designed to encourage. Therefore, virtually by definition, the estimate of the impact of this single component of the RTF proposal is understated, perhaps by a significant magnitude.

Ad Hoc concurs with Verizon that the proposed additional growth measures could result in higher universal service charges to consumers and that the Commission must require the RTF to determine the impact of each recommendation on the size of the fund prior to their implementation.[22] In order to evaluate whether the RTF proposal should be adopted in lieu of the FLEC approach previously adopted by the Commission, quantification of the RTF proposal must also include a comparison of the results to those that would be generated using a FLEC model. At a minimum, the Commission must require the RTF to demonstrate that the current level of funding is insufficient and that the quantified increase is necessary to ensure affordable rates for all consumers.

III. No Methodological Differences In The Treatment of Rural and Non-Rural Carriers Have Been Justified

Ad Hoc has urged the Commission to reject universal service mechanisms designed to impose a definitive methodological distinction between rural and non-rural carriers. As discussed in Ad Hoc's initial comments, the Commission should adopt the same methodological principles when establishing rural and non-rural support mechanisms since both rural and non-rural carriers serve high

[22] Verizon Comments at 2.

cost customers.[23] Specifically, both rural and non-rural carrier support should be determined using a forward-looking methodology.

The Maine Public Utilities Commission and the Vermont Public Service Board ("Rural State Commissions") state that "for every rural customer served by a 'rural telephone company,' there are four rural customers served by a non-rural company."[24] In other words, 80 percent of the nation's rural customers are not being served by rural carriers and therefore receive support through the non-rural support mechanism, and not the rural support mechanism that the RTF Recommendation aims to modify. This in itself justifies the use of a consistent methodology for determining both rural and non-rural carrier support.

Ad Hoc agrees with the statement made by the Rural State Commissions that support methods should not be based on the characteristics of the carrier but rather the cost characteristics of the area itself[25] and, Ad Hoc would add, the needs of the consumers living in those areas. The Commission must take the steps necessary to ensure that rural, high cost customers of both rural and non-rural carriers receive sufficient universal service support based upon a forward-looking methodology. If the methodologies for both rural and non-rural carriers are the same, then universal service support can be allocated to the high cost areas that could most benefit from the Fund, regardless of the nature of the serving carrier.

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[23] Ad Hoc Initial Comments at 12-15.

[24] Rural State Commissions Comments at 4.

[25] Rural State Commissions Comments at 2.

The adoption of the RTF Recommendation will exacerbate differences in the treatment of carriers serving similarly situated customers. Ad Hoc continues to urge the Commission to rely upon a FLEC mechanism to size rural carrier support and to ensure that the allocation of support for both rural and non-rural carriers is consistent.

IV. The RTF And MAG Proposals Seek Arbitrary Increases In The High Cost Loop Fund

A. The Cap on the High Cost Loop Fund Should Not Be Re-Based or Eliminated

Unlike several commenters, [26] Ad Hoc does not support the re-basing of the High Cost Loop ("HCL") Fund as proposed in the RTF Recommendation or the complete elimination of the HCL Fund cap as proposed in the MAG Petition. None of these commenters have proffered any evidence that *customers* located in rural America have been unable to obtain the telephone services contemplated by the Universal Service provisions of the Act as a result of the caps that are in place today – nor any evidence that less service will be available in the future. The RTF claims that its recommendation "should be sufficient to preserve and advance universal service in rural and insular areas, but remains capped to ensure the overall size of the fund is reasonable."[27] Yet the RTF has failed to establish that the fund as capped today is not *already* "sufficient to preserve and advance universal service."

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26 *See, e.g.*, Western Alliance Comments at 10-11; InterstateTelecom Group ("ITG") Comments 6-7; NECA Comments at 7; NTCA Comments at 3; SDITC Comments at 5; Arizona Local Exchange Carriers Associations ("Arizona LEC Association") Comments at 2-3. MAG Petition at 4.

27 RTF Comments at 4.

Ad Hoc concurs with the New York State Department of Public Service's ("NYDPS") claim that re-basing the cap on the HCL fund, and increasing universal support for rural carriers, would not provide the necessary incentive for rural carriers to invest efficiently in rural infrastructure.[28] As discussed in Ad Hoc's initial comments, the Commission prescribed the current indexed cap on the HCL fund to "encourage carriers to operate more efficiently by limiting the amount of support they receive" in the period preceding the rural carrier's transition to a forward looking methodology.[29] Any increase in the existing cap – and certainly the proposal in the MAG Petition to eliminate the cap – would eliminate these incentives.

Several commenters, including Western Alliance, JSI and ITG, argue that the cap on the HCL fund violates the requirement that the level of universal service funding be sufficient.[30] The RTF claims that the recommendation "produced a fund which balances the need for sufficiency with the need for reasonable limitations."[31] Ad Hoc emphatically disagrees. The RTF, the MAG, and the commenters in this proceeding have not provided any analysis or data to support their proposal for an increase in the HCL Fund. Ad Hoc agrees with California, WorldCom, and NYDPS that there is simply no evidence that the

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28 NYDPS Comments at 7-8.

29 *Universal Service Order* at ¶ 302.

30 Western Alliance Comments at 5; John Staurulakis, Inc., ("JSI") Comments at 5; ITG Comments at 4.

31 RTF Comments at 6.

current level of the Universal Service support is insufficient or inadequate to provide the necessary support to rural carriers.[32]

In its comments, WorldCom states that "contrary to the claims of some parties, the fact that there is a 'shortfall' between the current 'indexed cap' and the support that *would* be available if the cap were not in place does not, by itself, justify raising the cap."[33] Ad Hoc agrees and urges the Commission to reject any attempt to increase the fund that is not supported by a factual and persuasive record of insufficient universal service funding to rural carriers. The Commission can not lose sight of the fact that the purpose of the universal funding requirement is to ensure that all rural and insular customers can avail themselves of affordable telephone service, not to insulate carriers from their own investment decisions – a fact that many commenters in this proceeding conveniently ignore.

B. The Commission Should Apply An Annual Productivity Factor To The Indexed Cap On The HCL.

Contrary to the claims of RTF and MAG plan supporters that the HCL cap results in inadequate support (claims questioned by other commenters in this proceeding[34]), the available evidence suggests that the *cost* of providing the services supported by the fund have been declining. Therefore, rather than re-base the cap to produce an increase and arbitrarily grow the HCL funding level over time, the Commission should ensure that the cap properly reflects the increasing productivity gains and reduced costs that the telecommunications

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[32] WorldCom Comments at 2-3; California Comments at 4; NYDPS Comments at 4.

[33] WorldCom at 3 (footnote omitted; emphasis added).

[34] *See*, for example, California Comments, at 8; WorldCom Comments, at 3; NYDPS Comments, at 8.

industry experiences relative to the economy as a whole. To that end, Ad Hoc advocates the use of a productivity factor, like the so-called "X-factor" used by the Commission in its incentive regulation rules,[35] to ensure that HCL cap growth does not outstrip growth in carrier costs and reward inefficient investment.

Tier 1 LECs subject to the FCC's price caps plan have been subject to a 6.5% "X-factor" since 1997.[36] Ad Hoc proposes that the same "X-factor" formula (GDPPI – "X") be applied to adjust the HCL cap going forward. Since the adoption of the Commission's first LEC Price Cap Plan, the Commission has emphasized that "any form of regulation that is based on the costs of production must take productivity gains into account."[37] The X-factor accomplishes precisely this result. It "is an offset that reflects the fact that telephone carriers, historically, have experienced cost changes, due to differences in productivity and input prices relative to the economy as a whole, resulting in telephone rate trends being below the level of inflation."[38] Thus, the price cap index allows rates to move in relation to carriers' costs.

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35 *Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Report and Order and Second Further Notice of Proposed Rulemaking, 4 FCC Rcd 2873 (1989).

36 The "X" factor was last set at 6.5%, and although that "X" factor was remanded to the FCC, the majority of the Tier 1 LECs stipulated to its application as part of the recent CALLS proceeding. *See Price Cap Performance Review for Local Exchange Carriers and Access Charge Reform,* Fourth Report and Order in CC Docket No. 94-1, Second Report and Order in CC Docket No. 96-262, 12 FCC Rcd. 16642 ("*Price Cap Fourth Report and Order*"); *Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Low-Volume Long Distance Users, and Federal-State Joint Board on Universal Service,* Sixth Report and Order in CC Docket No. 96-262, Sixth Report and Order in CC Docket 94-1, Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45, 15 FCC Rcd 12962 *(2000) ("CALLS Order")*.

37 *Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Report and Order and Second Further Notice of Proposed Rulemaking, 4 FCC Rcd 2873 (1989) ("*Price Caps Report and Order*").

38 *Price Cap Performance Review for Local Exchange Carriers*, CC Docket No. 94-1, First Report and Order, 10 FCC Rcd 8961, 9006 (1995) *("LEC Price Caps First Report and Order")*.

As the Commission found in the price cap proceeding, [39] overall economy inflation measures (such as GDPPI) do not capture the entire productivity gains that telecommunications carriers are able to achieve because, as studies have shown, the telecommunications industry experiences larger productivity gains relative to the economy as a whole. Furthermore, the Commission has also found that telecommunications companies experience an input price differential, whereby the price of inputs they purchase tends to differ from the prices in the economy as a whole.[40] In other words, input costs for telecommunications carriers have tended to decline more quickly than prices of goods and services in general.

Ad Hoc believes that the same economic reasoning that led to a productivity factor in price caps formulae applies in the case of any HCL cap. California has commented that:

> There is no reason to believe, and the RTF has produced no evidence to conclude, that rural LECs' costs will reasonably increase in proportion to inflation and the number of access lines served, with no productivity gains, or that the High Cost Loop funding should increase by such amounts. Instead, the automatic increase in available funding [pursuant to the RTF plan] provides no incentive for rural LECs to become more efficient.[41]

As California suggests, the RTF's implicit assumption that rural carriers' costs will always be rising is fundamentally unsound. A policy that supports such faulty reasoning will only lead to inefficient investment decisions. Commenters in the MAG proceeding also support the use of a productivity factor to more

39 *See Price Caps Report and Order, supra,* note 37.

40 *LEC Price Caps First Report and Order* at 9033.

41 California Comments, at 8-9.

accurately track carrier cost changes. Specifically, Qwest, NASUCA, WorldCom and California have all submitted comments questioning the validity of a mechanism for rural carriers that allows prices to rise by an inflation factor and ignores cost-reducing productivity gains.[42]

Ad Hoc urges the Commission to incorporate the economic realities of the industry into any HCL cap mechanism or adjustment the Commission may adopt in this proceeding. The cap should not be re-based to reflect changes in GDPPI without also reflecting the reality that the telecommunications industry faces different input prices and exhibits greater productivity gains than the industry sectors otherwise reflected in GDPPI. Therefore, in order to re-base the HCF cap, the Commission should apply a factor to the HCF cap that reflects the productivity increases that have occurred since the original cap was instituted. Moreover, going forward, the funding allowed under the cap should be indexed using the GDPPI – X mechanism currently used by the Commission in its LEC Price Cap plan. To the extent that rural carriers can successfully demonstrate that their productivity characteristics differ from Tier 1 LECs, the Commission can specify a level for "X" that reflects those characteristics.

V. Limitations On Support For Acquired Exchanges.

A. The Record Does Not Support Elimination Of The Funding Cap For Transferred Exchanges

Several commenters, including NECA, Western Alliance, ITG, and NTCA, believe that the current universal service rules regarding acquired exchanges

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[42] Qwest MAG Comments, at 4-5; NASUCA MAG Comments, at 17-20; WorldCom MAG Comments, at 3-7, 16-18; California MAG Comments, at 21-24.

violate the statutory standard that universal service funds be "sufficient," and as such should be eliminated entirely.[43] Yet, once again, neither the RTF nor the commenters supporting the proposal have provided any evidence that the current level of support is insufficient and that additional support is necessary.

The universal service rules governing transferred exchanges are necessary to ensure efficient distribution and use of funding. As Ad Hoc observed in its initial comments, the Commission correctly concluded in its *Universal Service Order* that, until rural carriers transition to a new forward-looking support mechanism, all acquired exchanges will receive the same level of support per line as the seller received prior to the sale/transfer.[44] The preventive measure of capping Universal Service support for transferred exchanges was established by the Commission to ensure that the transfer of an exchange was not unduly influenced by a potential increase in Universal Service support.

If the Commission were to now eliminate the cap on Universal Service support for transferred exchanges, and either adopt the Safety Valve Mechanism as proposed by the RTF or repeal the universal service rules governing transferred exchanges entirely, the Commission would be creating an incentive for carriers to "game" the Universal Service system. California concurs with Ad Hoc in this view.[45] Ad Hoc believes that the appropriate time for the Commission to review and assess the validity of the cap on the Universal Service for transferred exchanges is when rural carriers have transitioned to a forward-

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[43] NECA Comments at 9-10; Western Alliance Comments at 7; ITG Comments at 11; NTCA Comments at 4-5.

[44] *See* Ad Hoc Initial Comments at 18; 47 C.F.R. 54.305; *Universal Service Order* at ¶ 288.

looking support mechanism. Until then, Ad Hoc urges the Commission to reject any attempt to increase the fund in the absence of a factual and persuasive record of insufficient universal service funding to rural carriers. As Ad Hoc and California have observed,[46] the RTF and commenters who support eliminating the cap on transferred exchanges at this time have failed to provide such a record.

B. The Proposed Safety Valve Mechanism Is Not Justified And Is Overbroad

As discussed in Ad Hoc's initial comments, the Commission should not adopt the Safety Valve Mechanism proposed by the RTF.[47] However, if the Commission does adopt the proposed mechanism, the types of investment that will be reimbursed by this mechanism must be explicitly identified. Specifically, the mechanism *should not* recover investments for services that are not currently supported by universal service.

In its Comments, the RTF defines the "Meaningful Investment" to be subsidized under the mechanism as "post-acquisition net annual increases in interstate telecommunications plant assets recorded under Part 32 and assigned to regulated records under Part 64 of the Commission's rules."[48] Under this broad definition of "Meaningful Investment," universal service funds could not only be used to support universal services, but could inappropriately be used to support all regulated services. But the Safety Valve Mechanism could not

45 California Comments at 13.

46 California Comments at 10.

47 Ad Hoc Initial Comments at 21.

48 RTF Comments at 6-7.

recover investments in services that are not currently designated for support pursuant to Section 254(c)(1) without violating that section and the Commission's procedural requirements for designating supported services.

Ad Hoc agrees with WorldCom that the rural carriers should be required to provide a detailed description of the investment that would trigger this mechanism[49] so that the Commission can ensure that only services designated for support receive a subsidy. The comments of CenturyTel illustrate the need for this information. In describing its past experience, CenturyTel states that

> [o]ften, CenturyTel is the first carrier ever to offer customers such common services as fiber optic facilities, digital switching, voice mail, caller ID, local dialup Internet access, and DSL. In one recent example, CenturyTel conservatively estimated that it would invest over $15 million in the first three years to upgrade facilities serving approximately 85,000 lines, an investment of over $175 *per line.*[50]

CenturyTel goes on to explain that this type of investment will not be possible without the "reasonable opportunity for recovery of the associated costs."[51]

Although CenturyTel is to be commended for making such a large investment in a newly acquired exchange, much of the investment CenturyTel describes should not qualify as "Meaningful Investment" eligible for universal service support because it is not associated with services eligible for universal service subsidies. In the *Universal Service Order*, the Commission defined the core services eligible to receive universal service support: single-party, voice grade access to the public switched network with Dual Tone Multifrequency

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49 WorldCom Comments at 3-4.

50 CenturyTel Comments at 3-4 (footnote omitted).

signaling or its functional equivalent and access to emergency services (including 911 and E911), operator services, interexchange services, directory assistance; and toll limitation services for qualifying low-income consumers.[52] Based on that criteria, CenturyTel's investments related to voice mail, caller ID, local dial-up Internet access, and DSL services should most certainly be excluded. Ad Hoc urges the Commission to (1) limit "Meaningful Investment" to investment associated with services eligible for Universal Service support pursuant to the Commission's rules; and (2) provide a detailed description of the investment that would be eligible for subsidy under the Safety Valve mechanism.

VI. The Commission Must Reject The RTF's Recommendation To Establish A Safety Net Additive Mechanism

Ad Hoc reiterates that the Commission should not establish an above-the-cap Safety Net Additive mechanism to reimburse rural carrier investment in Total Plant in Service ("TPIS") accounts.[53] Ad Hoc disagrees with commenters that advocate the complete elimination of the cap on the HCL fund so that the Safety Net Additive would not be necessary.[54] As discussed in Ad Hoc's initial comments, the RTF's "Safety Net Additive" is flawed because it does not limit support to investment associated with a service eligible for universal service support, [55] a defect reiterated by Sprint when it comments that the proposed

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51 CenturyTel Comments at 4.

52 Universal Service Order at ¶ 56.

53 *RTF Recommendation* at 27.

54 JSI Comments at 9; Western Alliance at 7; ITG Comments at 11.

55 Ad Hoc Initial Comments at 20-22.

safety valve support is not tied to any particular service.[56] Neither the RTF nor any of the commenters supporting the Safety Net Additive have demonstrated that there is a correlation between TPIS investment and the services targeted for support through universal service funding mechanisms. Therefore, an overall increase in TPIS investment does not necessarily indicate an investment in facilities used to provide services currently supported by Universal Service.

Ad Hoc agrees with the Competitive Universal Service Coalition ("CUSC") that rural carriers should not expect to recover their investments from other carriers' subscribers.[57] Accordingly, Ad Hoc urges the Commission to protect the sufficiency and integrity of the Universal Service Fund by rejecting the RTF's proposed Safety Net Additive mechanism.

If the Commission decides to adopt the mechanism, it should reject proposed modifications to increase the subsidy it provides. For example, several commenters recommend that the 14 percent threshold requirement of the Safety Net Additive be lowered and that the 50 percent recovery factor be increased.[58] Ad Hoc agrees with California that the RTF and supporting commenters have not provided any evidence that higher support levels are necessary.[59] Moreover, Ad Hoc agrees with WorldCom that, at a minimum, rural carriers should be required to provide a detailed description of the investment that triggers the mechanism,[60]

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56 Sprint at 4.

57 CUSC Comments at ii. *Accord,* Sprint Comments at 3.

58 SDITC Comments at 6; TCA Comments at 9.

59 California Comments at 9.

60 WorldCom Comments at 4.

the Commission should require the mechanism to be transparent, and the safety net mechanism should *only* support investment in universal services.

Furthermore, Ad Hoc agrees with California that it would be inappropriate to award a rural carrier Safety Net Additive support in all succeeding years, regardless of whether or not the carrier meets the 14 percent threshold requirement.[61] Under this aspect of the proposal, a carrier would be allowed to recover Safety Net Additive support in years when it could *disinvest* in TPIS investment accounts. Moreover, the construct of the Safety Net Additive would encourage carriers to delay making infrastructure investments until such time as investments meet the 14 percent threshold for one year. A system that would reward carriers for delaying investment, and one that can be so easily "gamed," has no place in the universal service subsidy mechanisms.

VII. The High Cost Fund III Should Be Funded With A New Per Line Charge and Subjected To An Annual Productivity Factor

Ad Hoc supports AT&T's suggested refinement of the RTF's proposed High Cost Fund III (HCF III) which, like the CALLS plan before it, would move interstate access charges closer to economically rational levels.[62] Specifically, AT&T's proposal to establish a new HCF III per line charge to collect the HCF III implicit subsidies removed from per minute charges makes sound economic sense. As a proponent of more economically rational pricing structures, Ad Hoc would support the HCF III as modified.

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61 California Comments at 9; Ad Hoc Comments at 20.

62 AT&T Comments at 4 – 11.

Unlike AT&T, however, Ad Hoc remains concerned that transfer of the revenue requirement presently collected from rural carriers' per minute access charges to a fixed HCF III will limit future reductions in the fund. As discussed in Section IV. B., *supra*, the costs of provisioning telephone service are declining, which should result in a decline in the revenues that should appropriately be collected by the HCF III fund. Therefore, for the same reasons discussed in Section IV.B. regarding the need for productivity adjustment to the HCL fund, the Commission should apply a productivity adjustment to the new HCF III funding requirement if the Commission chooses to adopt that mechanism.

VIII. Expanding Support to Advanced Services Would Be Improper In This Proceeding

The RTF proposed that the "Joint Board review the definition of the services that are supported by federal universal service support mechanisms, and that a 'no barriers to advanced services' policy be adopted."[63] Ad Hoc opposed that recommendation in its initial comments because the Commission has not, in this rural-specific support proceeding, established an appropriate forum for re-visiting the definition of supported services and determining whether advanced services satisfy the statutory standard in Section 254(c)(1). California, the NYDPS, and Sprint have submitted similar comments, noting that it is not at all clear that advanced services investment is a USF issue and that it must be defined as such before the RTF recommendation can be addressed.[64] In order to base its decision on an adequate evidentiary record and to provide sufficient

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[63] *RTF Recommendation* at 4.

[64] California Comments at 4; NYDPS Comments at 6; Sprint Comments at 3.

notice and an opportunity to comment, the Commission must consider the issue in a proceeding whose evidentiary record is not narrowly focused on the needs of rural customers.

The RTF has not provided a justification for expanding the current definition of supported services at this time to include the additional incremental facilities used to deliver advanced services. Most other commenters oppose the RTF's recommendation and few comments demonstrate why such a policy is justified. The CUSC notes that "while the objective of avoiding barriers to the provision of advanced services is commendable, neither the record developed by the RTF nor that supplied by commenting parties in the instant proceeding demonstrates any support for augmenting the list of supported services."[65]

If the Commission continues to believe that the inclusion of advanced services in the Universal Service mechanism is appropriate, Ad Hoc urges the Commission to open a new proceeding to address the issue. Such a proceeding is necessary to consider both the statutory standard for extending subsidies to a service and the dollar impact of doing so on the fund and other beneficiaries of support, both carriers and customers. California submits that the Commission must first answer questions regarding whether rural customers are limited in their access to the Internet and whether such access is due to the absence of quality facilities or other factors.[66] It is simply not appropriate to propose inclusion of an entire class of services in the fund before the problem has been adequately defined and a host of solutions have been studied.

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[65] CUSC Comments at 19.

CONCLUSION

For the reasons discussed above, the Commission should not swerve from its previous decision to use a forward-looking methodology to determine universal service support for rural carriers. All carriers who serve high-cost areas, whether rural or non-rural, should receive equitable universal service support. The RTF's recommendations to establish a Safety Net Additive and a Safety Valve Mechanism are flawed and should be rejected by the Commission. Any expansion of the subsidies for advanced services should be considered in a procedurally appropriate forum based on an adequate record. Rural carrier incentives to operate efficiently should not be compromised by any re-basing or

66 California Comments at 14-15.

re-sizing of the High Cost Loop Fund. Finally, a productivity factor should be applied to both the indexed cap on the High Cost Loop Fund and the RTF's recommended High Cost Loop Fund III.

Respectfully submitted,

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200.14/RTF/RPL COM FCC NPRM 3_15_01.doc

Certificate of Service

I, Anthony J. Mangino, hereby certify that true and correct copies of the preceding Reply Comments of the Ad Hoc Telecommunications Users Committee were served this March 15, 2001 via the FCC Electronic Comment Filing System ("ECFS") and were delivered by hand upon the following party:

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March 15, 2001